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October 4, 2002

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Marlene H. Dortch, Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W., TW-A325
Washington, D.C. 20554

EX PARTE PRESENTATION

EX PARTE OR LATE FILED

Re: Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128; Reply To The IXCs' Under-Recovery Claims

Dear Ms. Dortch:

The American Public Communications Council ("APCC") has shown that AT&T, WorldCom, and Sprint over-recovered their payphone compensation costs during the Interim Period (November 7, 1996 – October 6, 1997) and Intermediate Period (October 7, 1997 – April 21, 1999). Early on, the Commission made a finding in the *Third Payphone Order*, ¶199, that "IXCs have recovered from their customers the cost of compensating PSPs at a rate of $.284 per call."

The IXCs can claim they under-recovered only by positing their payphone-specific surcharges as their *only* cost recovery method. It wasn't. All three IXCs implemented rate increases for toll-free services and other services for the express, publicly stated purpose of recovering their dial-around compensation costs. The rate increases and their justification as payphone cost recovery were thoroughly reported in the trade press – as was the IXCs' failure to "roll back" the increases when the $.284 per call compensation rate and associated IXC "cost recovery" payphone surcharges took effect.

All three IXCs also shared in the $250 million annual access charge savings that resulted directly from the implementation of payphone compensation. The IXCs' revenues from these two cost recovery mechanisms alone far exceed the claimed shortfalls in the IXCs' payphone surcharge revenues.

While the IXCs try to dismiss these cost recovery mechanisms as irrelevant, the fact is that they were directly tied to payphone compensation. When IXCs *justify rate increases to customers* as payphone compensation cost recovery, the Commission should take them at their word. As for the IXCs' access charge savings, they exist solely *because* the LEC were required to recover payphone costs through *dial-around compensation instead of access charges.* Rational regulators must treat an IXC's payphone access charge reduction as an offsetting event that reduced the IXC's payphone compensation costs to be recovered.

In summary, the IXCs did not suffer any cost recovery *shortfall* for the Intermediate Period; they gained healthy cost recovery windfall *profits.* If they receive an Intermediate Period refund, their windfall profits from payphone compensation will increase even more.

No. of Copies rec'd 0+1
List ABCDE

Sincerely,

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American Public Communications Council

Docket No. 96-128

Payphone Compensation True-Up

REPLY TO THE IXCs' UNDER-RECOVERY CLAIMS

In this paper, submitted on behalf of the American Public Communications Council ("APCC"), we reply to the most recent attempts by AT&T, WorldCom, and Sprint to support their claims that they failed to recover their payphone compensation costs during the Interim Period (November 7, 1996 – October 6, 1997) and/or the Intermediate Period (October 7, 1997 – April 21, 1999).[1] In light of the contrary evidence long ago submitted in this proceeding, the only way that these interexchange carriers ("IXCs") can continue defending such claims is by ignoring the facts, or resorting to fanciful reinterpretations.

I. THE COMMISSION DID FIND THAT THE IXCS RECOVERED THEIR PAYMENTS

Sprint claims that "the Commission has never found that IXCs were compensated by their end-users for over-payments made to PSP." (Sprint Refund *Ex Parte* at 2, n.2), while WorldCom states that in the *Third Payphone Order* and the *Fourth Payphone Reconsideration Order*, the FCC "rejected" APCC's arguments to that effect. 2nd WorldCom Over-Recovery *Ex Parte* at 1.

These statements are easily refuted. In the *Third Payphone Order*, the Commission specifically found that "IXCs have recovered from their customers the cost of compensating PSPs at a rate of $.284 per call."[2] The Commission only left open the question of how much more the IXCs recovered in excess of their cost.

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1 *See* AT&T, WorldCom, and Sprint, joint ex parte letter, October 1, 2002 ("Joint IXC Refund *Ex Parte*"); AT&T, ex parte letter, October 1, 2002 ("AT&T's Over-Recovery Data *Ex Parte*"); WorldCom, notice of *ex parte* communication, "Refunds for Payphone Compensation," September 23, 2002, at 4-5 ("WorldCom Refund *Ex Parte*"); WorldCom, *ex parte* letter, October 1, 2002 ("WorldCom Over-Recovery *Ex Parte*"); WorldCom, *ex parte* letter, October 2, 2002 ("2nd WorldCom Over-Recovery *Ex Parte*"); Sprint, notice of *ex parte* communication, September 27, 2002, at 1-2 ("Sprint Refund *Ex Parte*").

2 *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996,* Third Report and Order, and Order on Reconsideration of the Second Report and Order, 14 FCC Rcd 2545, ¶199 (1999) ("*Third Payphone Order*"). In the *Fourth Payphone Reconsideration Order*, the Commission (footnote continued on next page)

II. THE IXCS' UNDERRECOVERY CLAIMS IGNORE THEIR 1997 RATE INCREASES AND RECURRING ACCESS CHARGE SAVINGS – BOTH TIED DIRECTLY TO PAYPHONE COMPENSATION

The IXCs' claim that they "substantially *underrecovered* from end users" is based solely on the allegation that "they were unable to recover surcharges for a significant percentage of the payphone compensation they paid." Joint IXC Refund *Ex Parte* at 8 (emphasis original). First, they say AT&T could not track all payphone calls and thus could not collect surcharges on all payphone calls; therefore AT&T "would remain undercompensated by almost $150 million for the Intermediate Period." *Id.* Second, they say WorldCom[3] and Sprint were unable to surcharge for the Interim Period; therefore they "recovered nothing for the Interim Period." IXC Joint Refund *Ex Parte* at 8; WorldCom Over-Recovery *Ex Parte* at 3. Third, they say WorldCom and Sprint could not track all payphone calls; therefore, "WorldCom has not surcharged its customers for $18 million" and Sprint missed collecting an undisclosed amount in surcharges. *Id.* at 3; Sprint Refund *Ex Parte* at 2. In each case, the IXCs have calculated an amount by which compensation costs allegedly exceeded surcharge revenues, and have claimed that amount as unrecovered compensation cost.

All of these claims are based on faulty reasoning, because they incorrectly (and misleadingly) portray surcharges as the only method by which IXCs recovered their costs during the Interim and Intermediate Periods. Nowhere do the IXCs' underrecovery claims take account of the various IXC cost recovery mechanisms that *supplemented* surcharges. For example, all three IXCs implemented rate increases for toll-free services and other services for the express, publicly stated purpose of recovering their dial-around compensation costs. Moreover, all three IXCs shared in the $250 million annual access charge savings that resulted directly from the implementation of payphone compensation.[4] The revenues brought in by these additional cost recovery measures were easily sufficient to cover the claimed shortfalls in the IXCs' payphone surcharge revenues.

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did not address the issue of whether the IXCs recovered their compensation costs. *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Fourth Order on Reconsideration, FCC 02-22, released January 31, 2002.

[3] For periods prior to the MCI-WorldCom merger, "MCI" and "LDDS WorldCom" refer to the individual companies, and "WorldCom" refers to MCI and LDDS WorldCom collectively.

[4] Section 276 required the local exchange carriers' ("LECs") to remove their payphone costs from the carrier common line charge – *so that they would recover their payphone costs through dial-around compensation instead of access charges. See* 47 U.S.C. §276(b)(1)(B).

APCC brought these redundant IXC cost recovery measures to the Commission's attention as early as August 1997. *See* Comments of American Public Communications Council, filed August 26, 1997, at 22-24, Att. 5-15. *See also* Letter to Chairman William Kennard from Vincent Sandusky, President, APCC, February 27, 1998. Thus, there was ample basis in the record for the Commission's understated finding, in the *Third Payphone Order*, that "IXCs have recovered from their customers the cost of compensating PSPs at a rate of $.284 per call." *Id.*, ¶199 (1999).

For five years, the IXCs have evaded discussion of these additional means of compensation cost recovery – to acknowledge them would be to concede that their claims of under-recovery are baseless. Now that they must acknowledge the mechanisms, the IXCs seek to obfuscate their significance. The facts regarding these cost recovery mechanisms and the amounts that the IXCs thereby recovered are summarized below.

A. The IXCs' Compensation-Inspired General Rate Increases Produced Gains Far in Excess of Any Conceivable Shortfall in the IXCs' Payphone Surcharge Revenue

Long before the IXCs implemented the payphone-specific surcharges they allegedly needed to recover their payphone compensation costs, the three largest IXCs *also* instituted general rate increases that they specifically and publicly stated were necessary to recover their payphone compensation costs. The earliest rate increases were instituted by MCI and Sprint in December 1996. AT&T followed in February 1997. Thus, by March 1997, all three IXCs had raised their toll-free ("8XX") service rates – AT&T by 3%, MCI by 4.9%, and Sprint by 2% – for both payphone and non-payphone calls, for the express purpose of recovering their dial-around compensation costs. *See* "AT&T Hikes Rates to Pass Along New Pay-Phone Charge," *Network World*, March 3, 1999 (Attachment 1 to this *ex parte*). *See also* APCC's *ex parte* letter, September 23, 2002, at 2 ("APCC's IXC Over-Recovery *Ex Parte*"). In May 1997, AT&T added an additional 7% increase on interstate toll-free services and a 2% increase in interstate outbound services, again expressly attributed to payphone compensation cost recovery. APCC's IXC Over-Recovery *Ex Parte* at 2. *See also* "News Brief," *Network World*, May 5, 1997 (Attachment 2 to this *ex parte*). MCI also further increased its rates,[5] and in April 1997 Sprint followed up its initial 2% toll-free service rate hike with an additional almost 5% increase in rates for toll-free services and other services. APCC's IXC Over-Recovery *Ex Parte* at 10.

[5] *See, e.g.*, Attachments 5 (December 8, 1997 report referring to MCI's "recent 800 price increases related to payphone compensation"), 7 (MCI's FCC tariff filing dated June 3, 1997, increasing rates for various outbound international services "as a result of the Payphone Recovery Order of the Federal Communications Commission"), and 8 (RBOC Coalition filing reporting that MCI raised its toll-free rates twice in 1997 to recover payphone compensation costs).

These rate increases generated huge amounts of additional revenue for the IXCs. As noted in APCC's IXC Over-Recovery *Ex Parte*, in 1998 Frost & Sullivan estimated that AT&T's rate increases tied to payphone compensation cost recovery gained AT&T $642 million in additional revenue for 1997 alone.[6] *See* Attachment 8 to this *ex parte*, last page. MCI's initial 4.9% rate hike alone[7] produced a minimum of $149 million[8] ($12.4 million per month) in additional revenue in 1997. Sprint's initial 2% increase gained it some $32 million in additional revenue in 1997 ($2.65 million per month) and its subsequent almost 5% rate increases must have generated more than $52 million ($6.5 million per month x 8 months) for a total of $84 million.[9]

While AT&T promised to "roll back" the increases if the FCC reduced the compensation rate, AT&T and other IXCs failed to do so. In fact, on several occasions in 1997 and 1998, trade press articles remarked that the increased toll-free rates remained in effect. On July 14, 1997, in reporting the court of appeals decision reversing the initial $.35 rate, Network World stated that:

> While the ruling should result in lower toll-free costs for users, they will have to wait a while before carriers roll back recent price increases on calls placed to 800 and 888 numbers. . . . AT&T stopped making the payments to pay phone owners right after the court issued its ruling, said Bill Archer, AT&T's marketing vice president for voice network services. But AT&T has not yet rolled back the 800 and 888 price increases to users because it does not yet know what new compensation rates the FCC will come up with, Archer said.

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6 Due to the time lag in quarterly payphone compensation payments, WorldCom's payments for the Interim Period, which ran from November 1996 to October 1997, were not due until the end of each calendar quarter in 1997. Thus, it is appropriate to treat WorldCom's revenue generated in 1997 as recovery of its Interim Period access charge payments.

7 APCC does not have enough information about MCI's additional rate increases to calculate the additional revenues generated, but the amount must have been much greater than the $149 million gained from MCI's initial December 1996 increase.

8 The revenue generated by this rate increase in 1997 was calculated by multiplying Frost & Sullivan's estimate of total industry annual toll-free revenues ($12.35 billion) by Frost & Sullivan's estimate of MCI's 1996 share of the domestic toll-free market (24.7%), and multiplying the result by 4.9%, the amount of MCI's rate increase. *See* APCC's IXC Over-Recovery *Ex Parte*, Att. 1. *See also* Attachment 9 to this *ex parte*.

9 The estimates for Sprint were calculated in the same way as MCI's except that the annual revenues resulting from the second rate increase were adjusted to reflect the portion of 1997 that it was in effect.

David Rohde, "Court Raps FCC for Pay Phone Plan," *Network World*, July 14, 1997, p. 27 (Attachment 3 to this *ex parte*). In October 1997, after FCC set the $.284 rate, *Network World* reported:

> Promises by long-distance carriers to rescind recent increases in 800 voice and data dial-up rates likely will be deferred following a new ruling by the Federal Communications Commission. . . . AT&T had promised to take back its 800 rate increases – which apply equally to dial connections for computer networks and to ordinary 800 voice calls – if the FCC significantly chopped the compensation rate. Now that seems highly unlikely. AT&T last hiked its 800 and 888 rates by 7% in May, on top of smaller increases earlier in the year."

David Rohde, "New Pay-Phone Ruling Upsets AT&T," *Network World*, October 20, 1997, p. 37 (Attachment 4 to this *ex parte*). Two months later, the increases still remained, even though the IXCs had already instituted their $.28 - $.30 payphone surcharges. Far from rolling back the increases, the IXCs continued raising their toll-free rates, citing other reasons. David Rohde, "FCC Hears 800 Number Rate Complaints," *Network World*, December 8, 1997, p. 39 (Attachment 5 to this *ex parte*). Six months later, a Business Communications Review columnist reported that the increases had not been rescinded. In fact, between March 1997 and February 1998, AT&T's 800 MegaCom service rates had increased 14%. Richard A. Kuehn, "Communications Management – the Headaches Continue; Rates of Long-Distance Telephone Service," *Business Communications Review*, May 1998, p. 66 (Attachment 6 to this *ex parte*).

In short, because the IXCs chose not to rescind their 1997 rate increases when the compensation rate was reduced to $.284 per call, the increases continued to produce revenues to offset the IXCs' payphone compensation costs during the Intermediate Period. For the 18.5-month recovery period for the Intermediate Period, these increases produced an additional $1.3 billion for AT&T, (APCC IXC Over-Recovery *Ex Parte* at 6-7), a minimum of $230 million for WorldCom,[10] and about $169 million for Sprint. The

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[10] As discussed above, MCI's rate increase for toll-free service generated revenues of at least $12.5 million per month during 1997. While WorldCom's share of the overall IXC long distance market declined somewhat in 1998, the decline is more than offset by the increase in the size of the market in 1998-99. *See* Attachment 9. *See also* FCC, Common Carrier Bureau, Industry Analysis Division, Statistics of the Long Distance Telecommunications Industry, Table 8 (January 2001). Therefore, it is reasonable to conclude that MCI received at least as much additional monthly revenue from this increase in 1998 and 1999 as in 1997. WorldCom therefore gained more than $230 million ($12.4 million x 18.5 months = $230 million) for the Intermediate period as a whole. Similarly, Sprint's revenues are estimated by multiplying its total monthly additional revenue for 1997 by 18.5 months (($2.65 million + $6.5 million) x 18.5 = $169 million).

revenues for AT&T and WorldCom are easily sufficient, by themselves, to wipe out the shortfalls in payphone surcharge revenues claimed by these IXCs.

The IXCs claim that APCC has brought up these rate increases because it wants the Commission to "apply a cost-based regulation scheme to competitive markets" and to make IXCs "cost justify each specific rate element, and provide uniform rate reductions for all products." *See* 2nd Worldcom Over-Recovery *Ex Parte.* APCC asks nothing of the kind. APCC is making a completely different point: When IXCs adopt major rate increases and *justify them to customers* as payphone compensation cost recovery, it is appropriate to take them at their word. At a minimum, the IXCs are estopped from later claiming that they need compensation refunds because they could not recover their compensation costs. And if IXCs have employed multiple "cost recovery" measures, resulting in double- or triple- "cost recovery" at their customers' expense, then that must be treated as a negative equity against the IXCs. This is especially appropriate when PSPs have shown that they have underrecovered *their* costs in every compensation period, even when charging higher rates.

B. The IXCs' Access Charge Savings

The IXCs' underrecovery claims equally disregard their access charge savings that resulted from the removal of the payphone subsidy from LEC access charges, effective April 15, 1997. As required by Section 276(b)(1)(B), these payphone cost elements were replaced by the system of dial-around compensation, for which the LECs became eligible on April 15, 1997. The removal of the payphone cost element and the resulting savings thus reduced IXCs' net costs of payphone compensation for both the Interim and Intermediate periods.

As noted in APCC's IXC Cost Recovery *Ex Parte*, the removal of LEC payphone subsidies reduced IXCs' access charge payments by about $250 million annually, on a recurring basis. *See* Petition of the Colorado Payphone Association for Partial Reconsideration, April 21, 1999, at 24. As a result, AT&T saved about $78 million in access charges in 1997. APCC's IXC Over-Recovery *Ex Parte* at 3. WorldCom and Sprint also saved amounts in proportion to their market shares. According to FCC statistics, WorldCom had roughly a 26% share of the IXC long distance market during this period.[11] Therefore, about 26% of the savings, *i.e.*, $65 million annually or $5.4 million per month, belonged to WorldCom. These cost savings from access charge reductions were in effect for 8.5 months of 1997, bringing WorldCom's total access charge cost savings in 1997 to

[11] *See* FCC, Common Carrier Bureau, Industry Analysis Division, Statistics of the Long Distance Telecommunications Industry, Table 8 (January 2001). An IXC's share of the market for toll services provided by IXCs is a reasonable approximation of its share of interstate access charges.

about $46 million ($5.4 million x 8.5 months). Similarly, with a 9.5% market share, Sprint saved about $2 million per month, or $17 million in 1997.

For the 18.5-month Intermediate Period, of course, the IXCs saved much larger amounts.[12] AT&T saved about $162 million (APCC's IXC Over-Recovery *Ex Parte* at 6) WorldCom saved some $92 million, and Sprint saved roughly $35 million.[13]

The IXCs contend that these access charge savings should not be counted as compensation cost recovery, because "[r]ates have declined more than all access charge reductions" and because the "Commission has consistently concluded that IXCs have passed through access charge reductions." WorldCom Refund Ex Parte at 5. *See also* 2nd WorldCom Over-Recovery Ex Parte at 2. In fact, rates for many long distance services did *not* decline when these access charge reductions took effect. As explained above, they *increased* during the Interim Period – because the IXCs claimed rate increases were needed for payphone compensation cost recovery. Therefore, WorldCom's claim that IXCs "passed through" their access charge reductions for the Interim Period falls rather flat. But in any event, even if IXCs had reduced their rates overall, the relevant point is that the IXCs' access charges were reduced *because* the LEC were required to recover payphone costs through *dial-around compensation instead of access charges.* There was a direct causal link between the IXCs' access charge reduction and its compensation payments. Thus, regardless of the overall direction of rates, any rational regulatory treatment of the compensation cost recovery must take account of this fundamental link, and must treat the payphone access charge reduction as an offsetting event that reduced the total payphone compensation costs to be recovered.

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12 Allowing an 18.5-month cost recovery period for the 18.5-month Intermediate Period, and timing the cost recovery period to begin January 1, 1998 (the end of the shortened cost recovery period assumed above for the Interim Period), WorldCom's cost recovery period for the Intermediate Period would end July 15, 1999.

13 In 1997 about 26% of the IXC industry's access charge savings went to WorldCom. Taking into account WorldCom's declining share of the interstate market (roughly 24% during the Intermediate Period), it is reasonable to project that about 24% of the interstate access charge savings went to WorldCom during the following 18.5 months. WorldCom thus saved about $60 million annually (24% of $250 million = $60 million), which is $5 million per month, or about $92 million (18.5 months x $5 million) for the Intermediate Period as a whole. Similarly, Sprint took about 9% of the savings, or $35 million ($1.88 million x 18.5 months).

* * *

Based on the analysis above, the IXCs' total cost recoveries from these sources are as follows. For the Interim Period, AT&T recovered $720 million ($642 million +$78 million), WorldCom recovered at least $195 million ($149 million + $46 million), and Sprint recovered at least $101 million ($84 million + $17 million).. For the Intermediate Period, *in addition to their payphone surcharges,* AT&T recovered $1.46 billion ($1.3 billion + $162 million), WorldCom recovered $322 million ($230 million + $92 million), and Sprint recovered $206 million ($169 million + $35 million). These amounts greatly exceed the payphone surcharge shortfalls claimed by AT&T and WorldCom, and any similar shortfall that could reasonably be claimed by Sprint.[14]

In summary, the IXCs did not suffer any cost recovery *shortfall* for the Intermediate Period; they gained healthy cost recovery windfall *profits.* If they receive Intermediate Period refunds, their windfall profits from payphone compensation will increase even more.

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[14] WorldCom's cost recovery does not include any revenues and cost savings gained by WorldCom in 1997 from (1) MCI's additional general rate increases instituted during 1997 (*see* note 5 above), and (2) any general rate increases that may have been assessed by LDDS WorldCom, as opposed to MCI, to recover payphone compensation costs. None of the IXCs' recoveries include their savings from the termination of *intra*state access charge subsidies of LEC payphones, also required by Section 276 (47 U.S.C. §276(b)(1)(B)), or from the replacement of 0+ commissions by dial-around compensation, the latter savings estimated by Frost & Sullivan to be $371.5 million in 1997.

ATTACHMENT 1

NETWORK WORLD ARTICLE ON AT&T RATE INCREASE
(MARCH 3, 1997)

Network World

March 3, 1997

SECTION: NEWS; Pg. 6

LENGTH: 348 words

HEADLINE: AT&T hikes rates to pass along new pay-phone charge

BYLINE: David Rohde

BODY:

Washington, D.C.

AT&T last week raised its inbound toll rates 3% across the board, blaming the rate hike on yet another quirky provision of the Telecommunications Act of 1996.

Analysts fear that the provision - concerning, of all things, pay phones - could lead to a series of rate hikes on 800 services throughout the year.

The telecom law re-quires long-distance carriers for the first time to compensate pay-phone owners for 800 calls that originate from their telephones. Until recently, callers have been able to march up to public phones and punch in 800 numbers to their heart's content, leaving pay-phone owners with neither coins in the till nor revenue for carrying the call.

But now AT&T and 21 other carriers that carry 800- and 888-number traffic are required to pay the equivalent of 35 cents per call to the owners of the nation's 350,000 independent pay phones.

Starting next month, the compensation scheme will be extended to the 1.8 million pay phones owned by regional Bell operating companies and other local exchange carriers.

AT&T's move also includes a 15-cent increase in its calling card surcharge. As a result, large corporate users of AT&T's Software Defined Network will likely see their costs rise because off-site access to SDN and similar voice-network plans is typically obtained via a calling card or 800 number.

MCI Communications Corp. and Sprint Corp. beat AT&T to the punch, with MCI hiking rates 4.9% and Sprint hiking them 2% in December.

Officials of all three carriers said they have to raise 800 rates not so much because Congress required them to compensate pay-phone owners, but because the Federal Communications Commission made the compensation scheme too generous.

The three carriers, plus a host of others last month, sued the FCC in federal appeals court to overturn the FCC's decision.

"We think it's a logical and reasonable argument to provide some compensation," said Bill Archer, AT&T's marketing vice president for global voice services. "But the amount of compensation doesn't seem fair and reasonable."

LOAD-DATE: March 4, 1997

ATTACHMENT 2

NETWORK WORLD NEWS BRIEFS (MAY 5, 1997)

Network World

May 5, 1997

SECTION: NEWS; News Briefs; Pg. 6

LENGTH: 570 words

HEADLINE: News Briefs

BODY:

News from Novell

Novell, Inc. next week at NetWorld+Interop 97 is expected to announce an agreement with Microsystems Software, Inc. under which Microsystems' Cyber Patrol content filtering technology will be built into Novell's upcoming Border Services product.

Announced at BrainShare last month, Border Services is a combination firewall and proxy server that sits at the edge of an IntranetWare network and provides secure access to Internet resources.

Novell also will unveil its strategy for giving IntranetWare users access to host-based information via the Web. Central to this strategy will be a technology code-named Meta Connect 3270, which converts 3270 datastreams into HTML format so the information can be viewed by any browser (NW, April 7, page 1).

Will Bay buy into Gigabit Ethernet?

Rumors were swirling last week that Bay Networks, Inc. had signed a letter of intent to buy Gigabit Ethernet start-up Rapid City Communications. The unconfirmed deal would give Bay some hot new products, including a family of Gigabit Ethernet devices that can switch and route on any port at wire speed. But Joe Kennedy, president and CEO of Rapid City, said there is no such agreement with Bay.

"We have had discussions with Bay and probably half a dozen other companies about acquisitions and OEM deals, and I can tell you that [the Bay] rumor is a vicious lie."

You're on the hook for pay phones

AT&T last week increased prices for its inbound 800- and 888-number services by 7%. The increase comes on top of a 3% in-crease in inbound service prices announced last February. AT&T blamed both the February rate hike and last week's action on a new federal regulation requiring carriers to compensate pay phone owners for 800 and 888 calls originating at their phones. But the 7% rate hike applies to all inbound calls, including those from regular home and business phones made to call centers. At the same time, AT&T also boosted rates 2% on outbound business services such as Software Defined Network and Switched Digital Services.

Cisco revving up new router

Cisco Systems, Inc. this week is expected to detail the components of its Gigabit Switch Router (GSR) project and announce the 3800 access multiplexer (NW, April 7, page 1) at NetWorld+Interop 97.

GSR is expected to include three models with bandwidth scalable to 80G bit/sec (NW, March 31, page 1).

Revisiting the Tandem-Microsoft alliance

Tandem Computers, Inc. and Microsoft Corp. penned a deal to cooperate on Windows NT-based clustered systems one year ago. Tandem next week will demonstrate the progress it has made on the technology in a half-day presentation in San Francisco led by Tandem CEO Roel Pieper.

The demonstration is expected to focus on an affordable fault-tolerant server cluster that uses Tandem's ServerNet technology as the physical connection among nodes and runs Microsoft's Wolfpack clustering software. These servers will also be running Tandem's cluster management software and ServerWare middleware.

Network Peripherals buys NetVision

LAN switch vendor Network Peripherals, Inc. last week announced that it will acquire NetVision, Inc., a privately held Application Specific Integrated Circuit company based on Long Island, N.Y., for $6 million. NetVision's low-cost IP switching and Gigabit Ethernet chips will form the foundation of Network Peripheral's new line of stackable switches.

GRAPHIC: Photo, Joe Kennedy

LOAD-DATE: May 6, 1997

ATTACHMENT 3

NETWORK WORLD ARTICLE REGARDING U.S. COURT OF APPEALS DECISION ON FCC PAYPHONE PLAN (JULY 14, 1997)

Network World

July 14, 1997

SECTION: CARRIER SERVICES; Telecom Rulings; Pg. 27

LENGTH: 340 words

HEADLINE: Court raps FCC for pay phone plan

BYLINE: David Rohde

BODY:

Washington, D.C.

A federal appeals court earlier this month partially overruled new Federal Com- munications Commission rules forcing many carriers to compensate pay phone owners for coinless, toll-free calls.

While the ruling should result in lower toll-free costs for users, they will have to wait a while before carriers roll back recent price increases on calls placed to 800 and 888 numbers.

The U.S. Court of Appeals for Washington, D.C. said the FCC compensation scheme is legal, but the amount set by the FCC, equivalent to 35 cents per call, is "arbitrary and capricious."

The court also said the FCC must impose the same rules on all carriers that carry toll-free calls.

The FCC initially had placed the burden only on larger carriers.

Going up

Citing the new costs, large long-distance carriers have raised 800 and 888 rates several times this year.

The price increases generally apply to all such calls, even those unrelated to the pay phone controversy, including 800 dial access to corporate networks and the Internet.

At the time, AT&T also raised some outbound business rates, noting it also must now compensate pay phone owners for calling card calls on plans such as AT&T's Software Defined Network service.

AT&T stopped making the payments to pay phone owners right after the court issued its ruling, said Bill Archer, AT&T's marketing vice president for voice network services.

But AT&T has not yet rolled back the 800 and 888 price increases to users because it does not yet know what new compensation rates the FCC will come up with, Archer said.

"We look forward to working with the FCC and the industry to establish compensation at a more reasonable level," added Ken Sichau, AT&T's vice president of business network services.

The controversy began after the nation's pay phone owners complained to Congress and the FCC that the dramatic rise in 800 and calling card calls left them bereft of coin revenue for a growing percentage of calls placed from their equipment (March 3, page 6).

GRAPHIC: Photo, Ken Sichau

LOAD-DATE: July 17, 1997

ATTACHMENT 4

NETWORK WORLD ARTICLE ON FCC PAYPHONE RULING
(OCTOBER 20, 1997)

Network World

October 20, 1997

SECTION: CARRIER SERVICES; Pg. 37

LENGTH: 475 words

HEADLINE: New pay-phone ruling upsets AT&T

BYLINE: David Rohde

BODY:

Washington, D.C

Promises by long-distance carriers to rescind recent increases in 800 voice and data dial-up rates likely will be deferred following a new ruling by the Federal Communications Commission.

The FCC has voted to give local exchange carriers and independent owners of pay telephones a new compensation rate of 28.4 cents per call for all toll-free and other coinless calls placed from their phones. The pay-phone owners will receive the compensation chiefly from long-distance carriers, which have been passing such charges along to users in the form of rate hikes on all 800 and 888 calls.

The FCC earlier this year set the pay-phone compensation rate at 35 cents per call, but that rate was overturned by a federal appeals court, which ordered the FCC to try again (NW, July 14, page 27). AT&T had demanded that the FCC reduce the rate to no more than 11 cents. Other carriers such as Sprint Corp. and WorldCom, Inc. suggested even lower figures.

AT&T reacted bitterly to the latest decision. "There is no sound economic data to support granting these [pay-phone] owners 28.4 cents per call," said Rick Bailey, AT&T vice president for federal government affairs. "The FCC is apparently intent on rewarding the pay-phone industry on the backs of customers, who will bear the brunt of this decision."

AT&T had promised to take back its 800 rate increases - which apply equally to dial connections for computer networks and to ordinary 800 voice calls - if the FCC significantly chopped the compensation rate. Now that seems highly unlikely. AT&T last hiked its 800 and 888 rates by 7% in May, on top of smaller increases earlier in the year. Bailey hinted that AT&T will take the matter back to court.

The prospect of continuing acrimony over the toll-free pay-phone compensation issue comes as the industry struggles to maintain the availability of new toll-free numbers. The FCC has implemented a plan to make sure the newly popular 888 numbers do not run out before next April, when the next toll-free area code - 877 - is slated to go into effect. Until then, large carriers will be allowed only to assign new numbers at the weekly rate of .95% of the 888 numbers they had in working status as of Aug. 23. Smaller carriers will be limited to 250 new numbers per week.

New numbering guru

Dealing with all these and related issues will be a new administrator of the nation's telephone numbering system. The FCC earlier this month selected a division of Lockheed Martin Corp. to replace Bell Communications Research as the North American Numbering Plan Administrator (NANPA).

The FCC's action culminates a five-year process of finding a successor to Bellcore, which was judged too partial to regional Bell operating companies to allocate sufficient phone numbers to alternative local carriers and their customers.

LOAD-DATE: October 23, 1997

ATTACHMENT 5

NETWORK WORLD ARTICLE ON FCC RATE INCREASES & SURCHARGES (DECEMBER 8, 1997)

Network World

December 8, 1997

SECTION: NEWS; Pg. 8

LENGTH: 484 words

HEADLINE: FCC hears 800 number rate complaints

BYLINE: David Rohde

BODY:

Washington, D.C.

Four rate hikes and a surcharge in one year are finally taking a toll on users of 800-number services.

Last week, a coalition of corporate users, along with the Consumer Federation of America, petitioned the Federal Communications Commission (FCC) to help roll back recent increases in 800 calling costs.

The coalition attacked recent FCC decisions requiring long-distance carriers to pay fees to the owners of pay phones every time someone dials an 800 or 888 number from their phones.

The group asked the FCC to reduce its current compensation rate of 28.4 cents per call to no more than 6 cents per call in hopes that long-distance carriers will pass along the savings.

AT&T cited the FCCs pay phone compensation schemes adopted in February and May as the reasons for across-the-board 800 price hikes.

There recently were two other 800 rate hikes which were the result of comprehensive AT&T rate increases (see graphic). The four moves apply to all 800 calls, even those that have nothing to do with a pay phone, such as using an 800 number to dial a remote access server or gain Internet access.

In addition, last month AT&T tacked on a 28-cent per call surcharge on calls it can identify as originating at pay phones.

MCI Communications Corp. and Sprint Corp. have instituted 30-cent surcharges in addition to their own recent 800 price increases.

The effect is potentially staggering. Orest Fiume, senior director of network services and workgroup technologies for Nabisco Brands Co., in Parsippany, N.J., estimated a $2.13 million, or 96%, increase in the annual cost of a program that requires sales personnel to dial in for updated route and customer service information.

"We've worked long and hard [negotiating with carriers] to bring our 800 rates down, and we've embedded it into this business process," Fiume said.

Others joining the coalition, dubbed the Consumer-Business Coalition for Fair Payphone-800 Fees include air- lines, trucking companies and the International Communications Association, a broad-based user group. The coalition also signed up advocacy groups for battered women and runaway kids who pleaded their work de-pends on receiving and paying for 800 calls originating at pay phones.

Some analysts, noting the recent sharp increase in AT&T's stock price, said users should not be aiming all their fire at the FCC. "[AT&T] should just absorb the cost," said Michael Hills, president of HTL Telemanagement, Ltd., a Burtonsville, Md., rate analysis and consulting firm.

An AT&T spokesman said that the carrier really is not pocketing the full 28-cent surcharge. The surcharge only is being added to users' gross volume, so it is subject to discounts negotiated by users. AT&T is hoping eventually to add the 28-cent surcharge after the discount, then it will consider rolling back rate hikes for non-pay phone 800 uses.

LOAD-DATE: December 11, 1997

ATTACHMENT 6

ARTICLE IN BUSINESS COMMUNICATIONS REVIEW ON FCC SURCHARGES (MAY, 1998)

Business Communications Review

May, 1998

SECTION: No. 5, Vol. 28; Pg. 66; ISSN: 0162-3885

IAC-ACC-NO: 20901719

LENGTH: 1501 words

HEADLINE: *Communications management - the headaches continue; rates of long-distance telephone service*

BYLINE: Kuehn, Richard A.

BODY:

In last month's column, I talked about the Universal Service Fund created by the FCC to support service to high-cost, rural areas and to subsidize modernization of networking/telecom for rural health care, libraries and K-12 educational facilities. The FCC's policy results in a 4.9 percent surcharge on international and interstate long-distance service. For most of us, that kick in the budget came as a surprise and, to some extent, the FCC was also surprised - it expected the carriers to absorb the costs in rerum for reduced access fees.

Well, surprises keep coming. AT&T claims the surcharge was not placed on interstate and international calls but, rather, on carriers' gross revenues. Thus, AT&T is informing customers that the surcharge also will apply to intrastate calls.

I don't think AT&T will have the final word. The FCC and Congress are getting peered, because more than two years after the Telecom Act, customers have yet to enjoy any significant rate relief.

But while the regulators express concern, the rest of us are in a pickle. For example, how should we negotiate for local and long-distance service? Will the surcharges continue, even as the FCC mandates further reductions in access charges? Or will carriers be forced to absorb the surcharges and will the access cost reductions end?

Without clear answers to those questions, the only thing to do is build plenty of flexibility into contracts. Some customers have negotiated the removal of the new surcharges and PICCs, but if the FCC eventually eliminates the charges altogether, a lot of work will have gone for nothing.

On the other hand, if the FCC allows the charges to stay in effect but forces down per-minute rates, customers might receive a reduction of up to 1.7 cents per minute over the next 12 months. A reduction of that magnitude would typically trigger a reopening of the contract.

So, however the issue is resolved, anyone negotiating a carrier contract today has to make sure:

* They're not paying unnecessary surcharges in return for gaining stable rates.

* They've left the door open for renegotiation, but in a way that doesn't extend the agreement's term.

Avoid Tariff "Creep"

All this uncertainty can drive you nuts! Recently I had to track rate increases for domestic and international calling. I was amazed: From March 1997 to February 1998, AT&T's SDN rates for domestic interstate service had increased by about 6 percent and its 800 MegaCom service had increased by 14 percent. (About 7 percent of the latter actually was imposed by the FCC 15 months ago to recover the cost of the 28.4 cent payphone surcharge, which is now showing up on our invoices.)

Rates at the state level for intrastate service were a mixed bag - increases ranged from zero to 10 percent. International services were more uniform - 6 percent increases almost across the board.

To understand why rates are rising, look no further than the law of supply and demand. I hear the carriers' networks are operating at roughly 85 percent of capacity, which negates the impact of competition; none of the carriers has an incentive to reduce prices to fill its network.

In my research, I found data on a broad range of prices. For example, Figures 1 and 2 (p. 64) show tariffed and negotiated rates for MegaCom 800 over the past 12 months. Notice that while the cost per minute and percentage increase both went up from 1996 to 1997, negotiated contract rates remained constant. This illustrates the danger of tying contracts to tariff rates: Negotiated, stabilized rates prevent tariff "creep," which rapidly erodes the value of any dollars negotiated.

Qwest's Quest

People talk about bandwidth being "free," but this whole situation has me worried. If the FCC forces down per-minute rates via reductions in access charges, the carriers may decide that rather than passing along the savings, they may simply issue new tariffed products. They've done that before and customers were faced with a tough decision: Either keep your higher rate under the "old" product, or transfer to the "new" lower-rate product but start the contract term all over again by doing so. I believe the technical term for this is: "Gotcha!"

But, you say, there's hope: Lower prices seem more readily available from the second-tier carriers. That, in turn, makes mergers like the one proposed by Qwest and LCI quite interesting. On the one hand, the new integrated network resulting from that merger will be large enough to drive prices lower. But what's unknown is how aggressive Qwest will be in pursuit of market share.

The carriers may also be increasing rates to set the stage for competition - i.e., when the LECs enter long distance and the FCC's Order on international accounting rates and settlements begins to take effect. By boosting rates now, they can "lower" them in response to competition - of course the lower rates will wind up at about the level we pay today. Long distance is going the way of the equipment business, where vendors tout big discounts off "list," but nobody knows what "list" really means.

And just as IXCs are playing games, the LECs aren't exactly babes in the woods. For example, there's been publicity about a T1 shortage - it takes a long time to get T1s provisioned, at least for dedicated long distance access.

Skeptic that I am, I can't help but wonder if there's really a shortage of T1s, or if at least some delays are deliberate. After all, who's missing the due dates? It's the LECs, who are perhaps taking a lesson from what AT&T did to MCI and Sprint in the mid 1970s: Support competition rhetorically, but sabotage it on the ground through delays. But the LECs wouldn't do that, would they?

CIC and CAC - or Is That Frick and Frack?

Amid all this guck, we are about to get another bite in the you-know-where: On July 1, the five-digit CAC (carrier access code), which is 10-XXX, where XXX is the three-digit CIC (carrier identification code - pronounced "kick"), will be expanded to a seven-digit code.

The current three-digit CICs will be expanded to four digits by adding a zero at the beginning; so, for example, if AT&T was your carrier, your CIC would go from 288 to 0288. Since the CICs per se are used mostly by LECs to route calls to your IXC, the impact of this change on end users is minimal.

But the CAC is also expanding, from 10- to 101-. Perhaps the most obvious change for end users will be seen in how calling-card calls are dialed instead of dialing 10288 for AT&T, you'll have to dial seven numbers: 101-0288. And MCI's heavily advertised 10-321 number will become 101-0321.

The reason for this change? Why, we're running out of numbers, don't you know. By increasing the size of the CIC and CAC, we'll be able to have more carriers. Won't that be special?

A couple of factoids to consider: In the 30 years between 1964 and 1994, only 14 new area codes were opened up, and roughly 700,000 numbers are available per area code.

But in the past three years - from 1995 to 1998 - 77 area codes have opened or been assigned. With those new area codes, there are now roughly 195 working area codes, which translates into an estimated 1.5 billion telephone numbers - five phone numbers per man, woman and child in the country. Who's really using all those numbers?

Conclusion

None of these items is a big-time technical issue. And yet each will affect how we do our jobs.

That 4.9 percent increase, on top of the other recent boosts in rates and the cost increases that stem from increased usage has one clear effect: Budgets go up and the job of managing enterprise communications becomes more difficult.

And how do you explain to management why, in this day and age, it takes so long to get a T1?

And when you explain to your users that they can't use their five-digit calling-card code, but have to punch in seven digits instead, they'll look at you like you're either incompetent or nuts.

And when that office that just opened up a few months ago has to order new stationery because the NXX just changed, people are going to start wondering if you really know what's going on.

So even though we are supposedly in this high-tech, info-age wonderland, it's the little things, the mundane stuff, that drives everyone crazy. Yet most people in our industry would rather debate network architectures or whether packet or circuit switching is the best way to handle traffic.

As for me, it's not that I don't care about the big technical issues, but what I want first is the ability to make a call at a reasonable cost - and to run my department with some semblance of sanity. Then I'll be happy to address the "big picture".

Richard A. Kuehn is the president of RAK Associates, a telecom consulting firm in Cleveland, OH. Mr. Kuehn is a well-known telecommunications lecturer and writer, and he was one of the founders of the Society of Telecommunications Consultants. He teaches BCR's Telecommunications Management course.

GRAPHIC: Graph; Illustration

IAC-CREATE-DATE: August 11, 1998

LOAD-DATE: August 12, 1998

ATTACHMENT 7

MCI TARIFF FILING REGARDING RATE INCREASE
(JUNE 3, 1997)

MCI Telecommunications
Corporation
1801 Pennsylvania, N.W.
Washington, DC 20006

Writer's direct telephone number: 202/887-2771

June 3, 1997

Transmittal No. 1083

Mr. William F. Caton, Acting Secretary
Federal Communications Commission
Washington, D.C. 20554

Attention: Common Carrier Bureau

Dear Mr. Caton:

MCI Telecommunications Corporation (MCI) hereby files with your office revised tariff material, attached hereto, in compliance with the Communications Act of 1934, as amended. This material consists of tariff pages as indicated on the following check sheets:

Tariff No. FCC 1 -- 1061st Revised Page No. 1;
446th Revised Page No. 1.1;
278th Revised Page No. 1.1.1;
228th Revised Page No. 1.1.1.1;
44th Revised Page No. 1.1.1.1.1; and,
185th Revised Page No. 1.2.

In Tariff FCC No. 1, MCI proposes make the following revisions to increase rates as a result of the Payphone Recovery Order of the Federal Communications Commission:

1. To increase per-minute usage charges for customers of Metered Use Service Option C (MCI WATS), Metered Use Service Option H (MCI Prism I), Metered Use Service Option I (MCI Prism II), and Metered Use Service Option J (University WATS) who place calls from international locations.

2. To increase per-minute usage charges for customers of Metered Use Service Option Q (MCI Vision) and Metered Use Service Option X (MCI HotelDirect) who place calls to international locations.

3. To increase per-minute usage charges for customers of Metered Use Service Option Q (MCI Vision) who subscribe to MCI Vision Worldwide for Latin America and who place calls to international locations.

4. To increase per-minute usage charges for customers of Metered Use Service Option Q (MCI Vision) who subscribe to MCI Vision Worldwide for Europe and who place calls to international locations.

5. To increase per-minute usage charges for customers of Metered Use Service Option Q (MCI Vision) who subscribe to MCI Vision Worldwide for Pacific Rim and who place calls to international locations.

6. To increase per-minute usage charges for customers of Metered Use Service Option G (Vnet) who place calls to international locations.

7. To increase per-minute usage charges for customers of Metered Use Service Option F (MCI 800 Service), Metered Use Service Option Q (MCI Vision - Inbound 800 Service), Metered Use Service Option R (MCI Preferred 800 Service), Metered Use Service Option X (MCI HotelDirect), Metered Use Service Option EE (MCI Flat Rate 800 Service), Metered Use Service Option KK (Flat Rate Plus 800 Service), and Metered Use Service Option OO (Advanced Option II for Small Business) and who subscribe to International Call Coverage Feature.

8. To increase per-minute usage charges for customers of Metered Use Service Option G (Vnet) who place calls which originate in Puerto Rico and terminate in international locations.

9. To increase per-minute usage charges for customers of Metered Use Service Option Q (MCI Vision) and Metered Use Service Option X (MCI HotelDirect) who place calls which originate in Puerto Rico and terminate in international locations.

10. To increase per-minute usage charges for customers of Metered Use Service Option Q (MCI Vision) who subscribe to MCI Vision Power Rate and who place calls to international locations.

11. To increase per-minute usage charges for customers of Metered Use Service Option Q (MCI Vision) who subscribe to MCI Vision Power Rate International 800 and who receive calls from international locations.

12. To increase most and reduce one per-minute usage charges for customers of Metered Use Service Option Q (MCI Vision) who subscribe to MCI Vision Worldwide Power Rate and who place calls to international locations.

13. To increase per-minute usage charges for customers of Metered Use Service Option HH (hospitalityMCI) who place calls from the U.S. Mainland and Hawaii to international locations.

14. To increase per-minute usage charges for customers of Metered Use Service Option F (MCI 800 Service), Metered Use Service Option Q (MCI Vision), Metered Use Service Option R (MCI Preferred), and Metered Use Service Option MM (networkMCI One) and who subscribe to International Toll Free Termination.

15. To increase per-minute usage charges for customers of Metered Use Service Option Q (MCI Vision) who subscribe to MCI Vision Switched International Program and who place calls to international locations.

16. To increase per-minute usage charges for customers of Metered Use Service Option MM (networkMCI One)who place calls to international locations.

17. To increase per-minute usage charges for customers of Metered Use Service Option MM (networkMCI One) who subscribe to International Toll Free Service and who receive calls from international locations.

18. To increase per-minute usage charges for customers of Metered Use Service Option G (Vnet) who subscribe to Virtual Network Connection.

19. To increase per-minute usage charges for customers of Metered Use Service Option Q (MCI Vision) who subscribe to Vision Virtual Network Connection.

20. To increase per-minute usage charges for customers of Metered Use Service Option Q (MCI Vision) who subscribe to MCI Vision Virtual Network Connection Worldwide Power Rate MCI Vision VNC Worldwide Power Rate.

21. To increase per-minute usage charges for customers of Metered Use Service Option MM (networkMCI One) who subscribe to networkMCI One Virtual Network Connection.

These revisions are scheduled to become effective on June 4, 1997.

In accordance with Section 61.33(a) of the Commission's rules, this original letter and the appropriate fee will be hand delivered on this date to the FCC in care of the Mellon Bank of Pittsburgh, PA. A copy of this letter is being served on this date upon the Secretary of the FCC, Washington, D.C. The new and revised pages of Tariff FCC No. 1 are being submitted on diskette pursuant to FCC Special Permission No. 96-661.

Please address any inquiries or further correspondence concerning this filing to James E. Kerr, Manager, Federal Tariffs, 1801 Pennsylvania Avenue, N.W., Washington, D.C. 20006. Any petitions made against this filing should be served personally or by facsimile upon Donald J. Elardo, Esq., Room 442, 1801 Pennsylvania Avenue, N.W., Washington, D.C. 20006 (telephone 202/887-2006; fax 202/887-3175).

Very truly yours,

James E. Kerr
Manager, Federal Tariffs

Attachments